Supreme Court, U. S.
FILED
AUG 15 1980
MICHAEL RODAK, JR., CLERK

No. 79-1266

In the Supreme Court of the United States

OCTOBER TERM, 1979

CHARLES W. STEADMAN, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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QUESTION PRESENTED

Whether, in an administrative proceeding before the Securities and Exchange Commission, violations by a fiduciary of antifraud provisions of the federal securities laws must be proven by clear and convincing evidence, rather than by a fair preponderance of the evidence.

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-34) is reported at 603 F.2d 1126. The opinion of the Securities and Exchange Commission (Supp. App. 1-122) is reported at 12 S.E.C. Docket 1041.

JURISDICTION

The judgment of the court of appeals (Pet. App. 35) was entered on October 4, 1979. A petition for rehearing was denied on November 27, 1979. The petition for a writ of certiorari was filed on February 15, 1980, and was granted on April 28, 1980. The jurisdiction of this Court rests on 28 U.S.C. 1254(1).

STATUTES INVOLVED

The relevant statutory provisions are set forth in the Appendix to this brief.

STATEMENT

This case concerns the standard of proof employed by the Securities and Exchange Commission in an administrative proceeding brought against petitioner Steadman, the president, chairman of the board of directors and sole owner of an investment adviser serving several mutual funds registered with the Commission under the Investment Company Act of 1940, 15 U.S.C. 80a-1 *et seq.* Petitioner is also the sole owner of several broker-dealer firms registered with the Commission under the Securities Exchange Act of 1934, 15 U.S.C. 78a *et seq.* After an administrative hearing, the Commission found by a preponderance of the evidence that petitioner had committed numerous violations of the federal securities laws. On review, the court of appeals upheld the Commission's use of that standard of proof in this administrative context.

1. The Regulatory Scheme

The federal securities laws contain several provisions empowering the Securities and Exchange Commission to impose sanctions on fiduciaries who have deviated from the standards imposed on them by Congress. Under Section 15(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78*o*(b), the Commission may impose any of a specified range of sanctions on brokers or dealers and associated persons, including censure, curtailment of activities, and suspension or revocation of registration. The Commission may impose such sanctions if it finds, on the record and after notice and an opportunity for a hearing, that the sanctions are in the public interest and that the respondent has, *inter alia*, willfully violated or aided and abetted a violation of the federal securities laws. Section 203 of the Investment Advisers Act of 1940, 15 U.S.C. 80b-3, vests the Commission with comparable authority to impose sanctions on investment advisers and associated persons. Sanctions ranging from censure to revocation of the registration of the adviser may be imposed.[1] Similarly, Section 9(b) of the Investment Company Act of 1940, 15 U.S.C. 80a-9(b), authorizes the Commission to prohibit persons who have willfully committed securities law violations from being associated with a registered investment company, either permanently or for a specified period of time, and to impose other sanctions on such persons as it deems appropriate in the public interest.[2]

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[1] These sanctions may be imposed based on the willful filing with the Commission of a misleading report or application for registration, on a criminal conviction in certain categories of cases, on the entry of specified injunctive orders, on willful violations of the federal securities laws or inability to comply therewith, or on willful aiding and abetting of violations of the federal securities laws. 15 U.S.C. 80b-3(e), (f).

[2] These sanctions may be imposed based on the willful filing with the Commission of a misleading registration statement,

Every respondent in an administrative proceeding brought pursuant to these statutory provisions enjoys procedural protections designed to assure a fair hearing and an accurate determination of factual questions. These protections are guaranteed by the Administrative Procedure Act, 5 U.S.C. 551 *et seq.*, and the Commission's Rules of Practice, 17 C.F.R. 201.1 *et seq.*, which enlarge the rights prescribed under the Administrative Procedure Act. Thus, a respondent is entitled to receive timely notice of the charges against him and the questions of fact and law to be determined (17 C.F.R. 201.6 (a)). He may retain counsel to represent him in connection with the proceeding (17 C.F.R. 201.2(b)), file an answer to the charges against him and move for a more definite statement of those charges (17 C.F.R. 201.7 (d)), and have a trial-type hearing presided over by an impartial administrative law judge (17 C.F.R. 201.11 (b)-(c)). The respondent may present oral or documentary evidence, cross-examine adverse witnesses, and object to the admission or exclusion of evidence (17 C.F.R. 201.14(a)). The Commission's rules provide that "[e]very party shall have the right to present such oral or documentary evidence and to conduct such cross-examination as may be required for a full and true disclosure of the facts" (*ibid.*). Subpoenas are available for the production of evidence (17 C.F.R. 201.14(b)), and witness statements in the possession of the Commission's staff may be requested for cross-examination purposes (17 C.F.R. 201.11.1). The "burden of proof" in such a hearing rests on the Commission's staff. 5 U.S.C. 556(d). At the completion of the hearing, the respondent has the right to submit briefs and proposed findings of fact and conclusions of law (17 C.F.R. 201.16(d)). The initial decision of the administrative law judge must include findings of fact and conclusions of law, with sup-

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application or report, on willful violations of the federal securities laws, or on willful aiding or abetting of violations of the federal securities laws. 15 U.S.C. 80a-9(b).

porting reasons, on all material issues of fact, law, or discretion presented on the record (5 U.S.C. 557(c); 17 C.F.R. 201.16(a)).

A respondent adversely affected by an initial decision of an administrative law judge may file a petition for review by the Commission (17 C.F.R. 201.17). Based on briefs, oral argument, the transcribed record, and any additional evidence presented, the Commission may reverse, affirm, or modify the initial decision of the administrative law judge based on its independent review of the record (17 C.F.R. 201.17(g)(2), 201.21). The Administrative Procedure Act provides that "[a] sanction may not be imposed * * * except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence" (5 U.S.C. 556(d)).

After exhausting his administrative remedies, a respondent has the right to file a petition for review of the Commission's decision in a court of appeals. The reviewing court has authority to affirm, modify or set aside the Commission's order, in whole or in part, and may also remand the proceeding to the Commission to receive additional evidence. A Commission order may be set aside by the court of appeals if it is unsupported by substantial evidence, if there has been a prejudicial departure from a procedure required by law, or if the order is arbitrary, capricious, or an abuse of discretion (5 U.S.C. 706(2)(A), (D), (E)).

2. The Proceeding Against Petitioner

In June 1971, the Commission instituted an administrative proceeding against petitioner and certain of his wholly owned companies, including Steadman Securities Corporation ("SSC"), an investment adviser registered with the Commission, and Republic Securities Corporation ("RSC"), a broker-dealer registered with the Commission. The administrative order initiating the proceeding alleged violations of numerous provisions of the federal securities laws resulting from petitioner's manage-

ment (through his wholly owned companies) of several mutual funds ("the Funds") registered under the Investment Company Act.[3]

After a lengthy evidentiary hearing, the Commission found that, over a seven-year period ranging from December 1965 to at least June 1972, petitioner repeatedly had violated antifraud,[4] reporting,[5] conflict of interest,[6] and proxy[7] provisions of the federal securities laws. Those violations included petitioner's willful concealment from the Funds' shareholders and directors of his practice of obtaining badly needed loans for himself and his companies at the same banks to which he caused the Funds to transfer, or in which he caused them to maintain, large cash deposits in non-interest-bearing checking accounts (Supp. App. 21-41).

From 1965 to 1968, the Funds maintained checking accounts at the Riggs National Bank in Washington, D.C. In 1968, petitioner's investment adviser firm (SSC) began an expansion program to acquire management rights for additional mutual funds. To finance these

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[3] At its height, petitioner's investment advisory organization had some $250 million of investor assets under management (Supp. App. 21).

[4] Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); Section 10(b) of the Securities Exchange Act, 15 U.S.C. 78j(b), and Rule 10b-5 thereunder, 17 C.F.R. 240.10b-5; Section 206(1) and (2) of the Investment Advisers Act, 15 U.S.C. 80b-6(1) and (2).

[5] Section 17(a) of the Securities Exchange Act, 15 U.S.C. 78q(a), and Rule 17a-5 thereunder, 17 C.F.R. 240.17a-5; Sections 30(a) and 34(b) of the Investment Company Act, 15 U.S.C. 80a-29(a) and 80a-33(b).

[6] Sections 15(a)(1), 17(a) and 17(e) of the Investment Company Act, 15 U.S.C. 80a-15(a)(1), 80a-17(a), and 80a-17(e).

[7] Section 20(a) of the Investment Company Act, 15 U.S.C. 80a-20(a).

acquisitions, SSC applied to Riggs for a $2 million loan. Riggs turned down the request. Petitioner then arranged a $3 million loan for SSC from the Chase Manhattan Bank in New York. While the Chase loan was being negotiated, petitioner recommended to the directors of several of the mutual funds that the Funds should transfer their bank accounts to Chase. The directors were told that Chase's fees were lower than Riggs' and that there had been "problems" with Riggs. The directors were not told about the Chase loan to SSC. The directors thereafter approved the transfer of the Funds' bank accounts (Pet. App. 3-4).

Subsequently, Riggs called its personal loans to petitioner, who then obtained a covering loan from the First National Bank of Washington. That loan was also called and petitioner was forced to negotiate a 90 day extension. Two days later, one of the Funds that petitioner managed purchased a 90 day certificate of deposit from First National in an amount larger than petitioner's loan (Pet. App. 4-5). To repay his loan to First National, petitioner obtained yet another loan from the National Bank of Washington. Shortly thereafter, bank accounts for one of the Funds were transferred to that bank from St. Louis. The directors of the Fund were not told about the loan to petitioner when they approved the transfer. None of the loans to petitioner and his corporations was disclosed in the mutual funds' prospectuses (*ibid.*).

In analyzing these transactions, the Commission observed (Supp. App. 26-28; footnotes omitted):

> [I]t would, we think, have been obvious to anyone (let alone someone with Steadman's extensive legal and financial experience) that the banking relationships were of considerable moment to anyone trying to formulate rational decisions about the investment merits of the Steadman-managed funds. Steadman had a self-interest in cultivating and mollifying the banks from which he borrowed. That self-interest [could have] led him to keep unduly large sums un-

> necessarily idle in checking accounts to the banks' benefit but to the funds' detriment.[8]

The Commission also found that petitioner willfully concealed these material facts and "intended to deceive" (Supp. App. 50-53). It added that his "systematic, calculated and protracted concealment of his collateral banking relationships is enough in itself to brand him an unfit manager of other people's money" (*id.* at 52-53).

The record disclosed other repeated and flagrant statutory violations. Petitioner was found to be responsible for the late filing of required annual reports for three of the Funds in three consecutive years. The Commission noted that "[i]n many instances the reports were filed so late as to be of minimal value in serving the purposes intended by the requirements for filing the reports" (Supp. App. 78). In fact, no reports at all were filed during 1971 (*id.* at 78 n.67). Petitioner, who had received repeated warnings from his auditors about related deficiencies (*id.* at 82), nonetheless "chose to save money" by "flout[ing] basic regulatory requirements" (*id.* at 83).[9]

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[8] The Commission found it unnecessary to determine whether petitioner actually used the banking accounts as a *quid pro quo* for the loans made to him and his companies. Rather, the Commission concluded (Supp. App. 28) that, regardless of the connection between the loans and the transfer of the banking accounts, petitioner "had disabled himself from looking at the funds' checking account balances in a wholly disinterested way, with an eye single to the funds' best interests." Under these circumstances, petitioner was required to disclose his serious conflicts of interest. The Commission added that "it is hard to believe that there was no link at all between the funds' deposits and the benefits to Steadman" (Supp. App. 38-39 n.15).

[9] The Commission added that "[t]he matter would be serious enough if we were dealing only with the respondents' failure to file their own reports. But there is much more to it than that. Many of the reports involved were due not

The Commission also found that petitioner had willfully violated, or willfully aided and abetted violations of, various provisions of the Investment Company Act intended to prevent self-dealing and conflicts of interest. For example, petitioner arranged for SSC to defer repayment to the Funds of $260,000 in excess advisory fees that it had received from the Funds (Supp. App. 67-73). The Commission found that "SSC very much wanted to hold on to the money that it was supposed to return to the investment companies" (*id.* at 70) and paid the Funds an unfairly low interest rate (*id.* at 71). The Commission also found that these self-dealing transactions had been concealed (*id.* at 72). Similarly, the Commission found that petitioner had caused his brokerage firm (RSC) to accept and retain certain tender solicitation fees that rightfully belonged to the Funds (*id.* at 73-77).[10]

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from them but from their investment company clients. They were under fiduciary and contractual duties to those clients to file the reports on time" (Supp. App. 85).

[10] In summary, the Commission found that (i) petitioner violated antifraud, proxy, and reporting provisions by failing to disclose the bank loans (Supp. App. 33-41); (ii) RSC, aided and abetted by SSC and petitioner, wrongfully accepted and retained solicitation fees paid by tender offerors to soliciting brokers for the tender of securities held by the Funds in violation of Section 17(e) of the Investment Company Act, 15 U.S.C. 80a-17(e) (Supp. App. 73-77); (iii) SSC violated Section 15(a)(1) of the Investment Company Act, 15 U.S.C. 80a-15(a)(1), by failing promptly to remit to the Funds excess advisory fees (Supp. App. 67-71); (iv) petitioner and SSC violated various antifraud and reporting provisions by failing to disclose to shareholders of the Funds that SSC had retained these excess fees (Supp. App. 72-73); (v) petitioner and SSC aided and abetted violations of Section 17(a) of the Investment Company Act, 15 U.S.C. 80a-17(a), by causing certain of the Funds to buy securities from and sell securities to other Funds (Supp. App. 85-94); and (vi) petitioner, SSC, and its subsidiaries violated Section 30(a) of the Invest-

In light of petitioner's continuing "deceit" and "reckless disregard of applicable filing requirements" (Supp. App. 95)—conduct that showed that he was a "faithless fiduciary" (*id.* at 99)—the Commission determined that petitioner should be barred from association with any investment adviser or registered investment company and also should be suspended for one year from association with any broker or dealer in securities (*id.* at 99-113). The Commission explained that its debarment order was subject to "modification" in the future if petitioner made a showing entitling him to relief (*id.* at 119-120 n.100).[11]

In making the factual findings that supported its order in this case, the Commission used the preponderance of the evidence standard of proof (Supp. App. 97-99 n.88). It noted that "in remedial proceedings of this character a preponderance of the evidence is sufficient to establish the truth of an allegation" (*ibid.*).

3. The Decision of the Court of Appeals

Petitioner sought review of the Commission's decision in the United States Court of Appeals for the Fifth

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ment Company Act, 15 U.S.C. 80a-29(a), and Section 17(a) of the Securities Exchange Act, 15 U.S.C. 78q(a), by failing to file timely reports (Supp. App. 78-85).

[11] In explaining the relative severity of its order, the Commission stated that "[w]hen the misconduct is as egregious as it is in this case, we must take effective measures to protect investors and the public interest from future harm * * *." It added that "[l]eniency in a case of this character is bound to encourage irresponsibility, cavalier attitudes toward basic disclosure obligations, and disregard for inconvenient filing requirements" (Supp. App. 98-99). Nevertheless, the Commission gave petitioner 90 days in which to divest his stock interests in the respondent companies, a period of time that it found to be sufficient to locate a buyer and avoid an economic loss (*id.* at 114). Compliance with the Commission's order has been stayed for over three years pending completion of judicial review.

Circuit, contending, *inter alia*, that the Commission was required to utilize the clear and convincing evidence standard of proof rather than the preponderance of the evidence standard in evaluating the record. The court of appeals rejected that contention (Pet. App. 26). In holding that proof by a preponderance of the evidence was sufficient, the court declined to follow *Collins Securities Corp.* v. *SEC*, 562 F.2d 820, 824 (D.C. Cir. 1977), which had required the clear and convincing evidence standard in a Commission proceeding. Instead of following *Collins*, the court of appeals applied the analysis set forth by this Court in *Addington* v. *Texas*, 441 U.S. 418, 423-433 (1979). Pursuant to *Addington*, it weighed the respective interests of the parties to arrive at the proper allocation of the risk of factual error (Pet. App. 26):

> Balanced against the risk to Steadman is the risk that the investing public will be inadequately protected. The public interest in high standards of conduct in the securities business is a great one. If the burden of proof imposed on the Commission is too high, its ability to police the industry is impaired. We cannot say here, as the Court could in *Addington* v. *Texas*, *id.* at 427, * * * that "the possible injury to the individual is significantly greater than any possible harm to the state."

Because the risk to petitioner that an erroneous finding of fact would lead to his exclusion from the investment advisory business did not outweigh the risk to investors that such an error would permit a faithless fiduciary to continue in his position of trust, the court held that it was appropriate for both parties to bear the risk of error equally through use of the preponderance of the evidence standard (Pet. App. 26).

The court rejected the argument that clear and convincing evidence is required in this context because some of the charges against petitioner rested on violations of antifraud provisions of the federal securities laws. The court noted (Pet. App. 25) that Section 17(a)(2) and

(3) of the Securities Act, 15 U.S.C. 77q(a)(2) and (3), and Section 206(2) of the Investment Advisers Act, 15 U.S.C. 80b-6(2), relied on by the Commission in this case,

> are commonly called "antifraud" provisions, but the offenses they define are fraud in the broadest "remedial" sense of that term and require no showing of intent to injure or injury. See *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 * * * (1963). The facts necessary to establish a violation of these sections—nondisclosure of a material fact—are capable of proof by ordinary direct or circumstantial evidence as in any other administrative proceeding.

The court of appeals expressed concern, however, about the Commission's justification for its selection of severe sanctions in this case. Accordingly, the court remanded the case to the Commission for a further explanation of its rationale for the particular sanctions imposed on petitioner (Pet. App. 27):

> We subscribe to the common-sense notion that the greater the sanction the Commission decides to impose, the greater is its burden of justification. Where, as here, the most potent weapon in the Commission's "arsenal of flexible enforcement powers" * * * is used, the Commission has an obligation to explain why a less drastic remedy would not suffice.

SUMMARY OF ARGUMENT

I.

Selection of the appropriate standard of proof in this case requires a balancing of the individual interest asserted by petitioner and the interest sought to be protected by the Securities and Exchange Commission. When both sides to a controversy have approximately equal interests in avoiding erroneous factual findings, they should "share the risk of error in roughly equal fashion" under the traditional preponderance of the evidence

standard of proof. *Addington* v. *Texas*, 441 U.S. 418, 423 (1979). In this case, petitioner has presented no valid reason why his interest in avoiding an erroneous factual determination outweighs that of the investors whom the Commission seeks to protect. Those investors have entrusted petitioner with hundreds of millions of dollars, and an accurate evaluation of petitioner's fitness to continue in his position of trust is of crucial importance to them. To put petitioner's personal economic interest ahead of that of his investor clients would conflict with elementary concepts of fiduciary duty embodied in the federal securities laws.

The traditional standard of proof in civil litigation is the fair preponderance of the evidence, a standard that governs in proceedings brought under the antifraud provisions of the federal securities laws and even in civil penalty proceedings. That standard assures that decisions in every case rest on the most likely and probable factual inferences. In contrast, petitioner's proposed standard would mean that, in cases in which "clear and convincing evidence" is unavailable, the public would be denied protection even though each and every prerequisite for extending that protection was established by the preponderating weight of the evidence. That result would conflict with the need for accurate administrative adjudications. And considerations of fairness do not require it. Fairness in the present context is guaranteed to petitioner by his right to a trial-type hearing, with numerous procedural safeguards, and subsequent judicial review.

This case bears no resemblance to cases in which this Court has required clear and convincing evidence. Petitioner's economic interest is not similar to that of persons threatened with deportation or indefinite confinement in a mental institution. Indeed, petitioner's interest is substantially less significant than the interest considered in *Vance* v. *Terrazas*, No. 78-1143 (Jan. 15, 1980). That case held that the Due Process Clause does

not require proof by clear and convincing evidence that an individual intended to surrender United States citizenship. *Terrazas* provides *a fortiori* support for the conclusion that the Due Process Clause does not require clear and convincing evidence here.

The fact that clear and convincing evidence has been required in certain common law fraud cases is not relevant to the issues presented in this case. This is a statutory proceeding brought under remedial provisions of the federal securities laws, which is intended to protect investors against future harm by removal of a dishonest trustee. In such a context, common law fraud doctrines are not pertinent. Moreover, the better considered common law decisions recognize that it is inappropriate to create special evidentiary advantages for those accused of fraud to the detriment of those claiming to be their injured victims, and therefore these authorities approve use of the preponderance of the evidence standard in resolving allegations of fraud.

Nor are petitioner's contentions supported by the fact that certain states require clear and convincing evidence before disbarring attorneys. State authorities examine attorneys to evaluate their professional competence, character, and fitness. By judicial order, attorneys are certified to be officers of the court. In contrast, the Commission does not examine investment advisers to determine their competence or character. Accordingly, there is no overriding presumption in favor of their adherence to professional standards. Moreover, the better reasoned state authorities recognize that, even in attorney disbarment proceedings, the public interest requires that the decision of the disciplining body be rendered under the fair preponderance standard, not the clear and convincing standard.

The fact that Commission adjudications may depend on circumstantial or inferential proof is not a ground for requiring clear and convincing evidence. This Court repeatedly has recognized that circumstantial evidence con-

tributes to reliable adjudications. Federal courts and administrative agencies routinely consider circumstantial evidence, along with direct evidence, under the preponderance of the evidence standard.

II.

In the absence of Due Process constraints, a congressional determination that a particular standard of proof is applicable is entitled to judicial deference. See *Vance* v. *Terrazas*, *supra*, slip op. 13-14. In the present context, that standard of proof is the standard contained in the Administrative Procedure Act. Section 7(c) of the Act, 5 U.S.C. 556(d), provides that sanctions may be imposed in administrative proceedings if the evidence is "reliable, probative, and substantial." The legislative history confirms that Congress intended this language to embody the traditional preponderance of the evidence standard. See H.R. Rep. No. 1980, 79th Cong., 2d Sess. 37 (1946): "Where there is evidence pro and con, the agency must weigh it and decide in accordance with the preponderance." In reliance on the APA, the Commission consistently has applied the preponderance of the evidence standard in its adjudicatory proceedings.

III.

Even if the Administrative Procedure Act did not prescribe a standard of proof, the Commission's view that proof by a preponderance is appropriate should be upheld. As this Court noted in *Mathews* v. *Eldridge*, 424 U.S. 319, 349 (1976), "substantial weight must be given to the good-faith judgments of the [persons] charged by Congress with the administration of [the statute] that the procedures they have provided assure fair consideration of the * * * claims of individuals." This Court also confirmed in *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council*, 435 U.S. 519, 524 (1978), that the APA prescribes "the maximum procedural requirements which Congress was willing to have

the courts impose upon agencies * * *." Accordingly, "[a]gencies are free to grant additional procedural rights in the exercise of their discretion, but reviewing courts are generally not free to impose them if the agencies have not chosen to grant them."

In view of these principles, this Court should affirm the Commission's reasonable determination that the preponderance of the evidence standard of proof, which requires securities industry fiduciaries to share equally with investors the risk of an erroneous factual finding, is the standard that governs in this administrative proceeding.

ARGUMENT

THE SECURITIES AND EXCHANGE COMMISSION APPROPRIATELY UTILIZED THE PREPONDERANCE OF THE EVIDENCE STANDARD OF PROOF IN THIS ADMINISTRATIVE PROCEEDING

I. A Proper Balancing of the Public and Private Interests in This Case Requires Use of the Preponderance of the Evidence Standard

Following an extensive administrative hearing in which petitioner's right to present evidence and to confront the evidence against him was scrupulously respected, the Commission determined that petitioner had committed numerous violations of, and that sanctions should be imposed under, the federal securities laws, including the Investment Advisers Act and the Investment Company Act. As this Court repeatedly has stated, these statutes were adopted by Congress to establish "federal fiduciary standards" to govern the conduct of investment advisers.[12] Despite the fact that petitioner is a fiduciary

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[12] *Aaron* v. *SEC*, No. 79-66 (June 2, 1980), slip op. 11-12; *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, 444 U.S. 11, 17 (1979); *Burks* v. *Lasker*, 441 U.S. 471, 481-482 n.10 (1979); *Santa Fe Industries, Inc.* v. *Green*, 430 U.S. 462, 471 n.11 (1977); *SEC* v. *Capital Gains Research Bureau, Inc.*, 375

and was proceeded against under statutory provisions intended to protect investors against misconduct by their fiduciaries, petitioner claims (Br. 7-15) that the standard of proof in such a proceeding should allocate a much greater risk of error to investors than to himself. There is no support for such a paradoxical contention.

As this Court observed in *Addington* v. *Texas*, 441 U.S. 418, 423 (1979), the standard of proof utilized in a trial-type proceeding "serves to allocate the risk of error between the litigants." Under the traditional preponderance of the evidence standard, the parties bear roughly the same risk of error. A standard of proof more stringent than the traditional preponderance standard protects the favored party against an erroneous decision that is adverse to him, but *increases* the overall likelihood of an erroneous decision. This special measure of protection at the cost of increased error is tolerable only "when the possible injury to the individual is significantly greater than any possible harm to the state." *Id.* at 427. Where, as here, the interests of the fiduciary do not outweigh the interests of the class of investors that the government seeks to protect, there is no valid reason for adopting a standard of proof that would shift the risk of error from the fiduciary and expose his beneficiaries to an increased number of decisional errors.

Unless the premise is accepted that the securities laws are designed to protect those with fiduciary obligations rather than their investor beneficiaries—or, stated otherwise, that it is better that several dishonest trustees remain in their position of trust than that one honest trustee should be mistakenly removed—there is no plausible basis for holding that the Commission must utilize

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U.S. 180, 191-192 (1963). It has likewise been recognized in proceedings under the Securities Act and the Securities Exchange Act that fiduciary obligations rest on broker-dealers. See, *e.g.*, *Mansbach* v. *Prescott, Ball & Turben*, 598 F.2d 1017, 1026 (6th Cir. 1979); *Sinclair* v. *SEC*, 444 F.2d 399, 400 (2d Cir. 1971).

a standard of proof more stringent than the preponderance standard. In the present context, a standard of proof that asks the fiduciary "to share equally with society the risk of error" (*Addington* v. *Texas*, *supra*, 441 U.S. at 427) is generous to the fiduciary and cannot be questioned on grounds of accuracy or fairness.

A. *The Traditional Preponderance of the Evidence Standard of Proof is Needed to Minimize Decisional Errors*

Contrary to petitioner's contention (Br. 7, 10, 14-15), use of a "clear and convincing evidence" standard of proof would not contribute to factual accuracy. To the contrary, the preponderance standard of proof is the standard best calculated to arrive at correct factual determinations. Moreover, contrary to the assertion of amicus Securities Industry Association (SIA Br. 8), the overwhelming weight of judicial precedent supports the proposition that the preponderance standard governs here.

With the exception of certain recent decisions of a single court of appeals (see *Collins Securities Corp.* v. *SEC*, 562 F.2d 820 (D.C. Cir. 1977); *Whitney* v. *SEC*, 604 F.2d 676 (D.C. Cir. 1979)), the lower courts consistently have held that administrative adjudications under the federal securities laws do not require a standard of proof greater than the preponderance standard.[13] The lower courts have reached the same result in other ad-

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[13] In addition to the decision of the Fifth Circuit in the present case, see *Investors Research Corp.* v. *SEC*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 97,526 at 97,753 n.41 (D.C. Cir. 1980), petition for cert. pending, No. 80-128; *Abbett, Sommer & Co.* v. *SEC*, [1970-1971] Fed. Sec. L. Rep. (CCH) ¶ 92,813 (D.C. Cir. 1970), cert. denied, 401 U.S. 974 (1971); *DeMammos* v. *SEC*, 23 Ad. L.2d 221 (2d Cir. 1967), aff'g 43 S.E.C. 333, 337 (1967); *Wright* v. *SEC*, 112 F.2d 89, 94 (2d Cir. 1940). See also *Public Service Corp.* v. *SEC*, 129 F.2d 899, 902 (3d Cir.), cert. denied, 317 U.S. 691 (1942); *Pacific Gas & Electric Co.* v. *SEC*, 127 F.2d 378, 382 (9th Cir. 1942).

ministrative contexts, concluding that a preponderance of the evidence is sufficient.[14]

It is likewise well established that issues of fact in civil actions generally are determined in accordance with the preponderance of the evidence.[15] Not only has the traditional civil standard—the preponderance of evidence—been routinely employed by federal courts in civil actions arising under the securities laws,[16] but its use

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[14] See *Martinez* v. *Blum*, No. 80-6002 (2d Cir. June 9, 1980), slip op. 3429 (rejecting the contention that termination of AFDC benefits must be supported by clear and convincing evidence); *Walters* v. *McLucas*, 597 F.2d 1230, 1232 (9th Cir.), cert. denied, 444 U.S. 932 (1979) (approving the preponderance of the evidence standard in an FAA proceeding to revoke a private pilot's license based on violations of aviation regulations and a prior drug conviction); *Alsbury* v. *United States Postal Service*, 530 F.2d 852, 855 (9th Cir.), cert. denied, 429 U.S. 828 (1976) (discharge of postal employee for unlawful removal of government property); *Polcover* v. *Secretary of the Treasury*, 477 F.2d 1223, 1231 (D.C. Cir.), cert. denied, 414 U.S. 1001 (1973) (removal of IRS agent from employment for accepting bribe); *Cargill, Inc.* v. *Hardin*, 452 F.2d 1154, 1169 (8th Cir. 1971), cert. denied, 406 U.S. 932 (1972) (manipulation of price of wheat futures); *Kent* v. *Hardin*, 425 F.2d 1346, 1349 (5th Cir. 1970) (suspension of commodities broker).

[15] See *Addington* v. *Texas*, 441 U.S. 418, 423 (1979); *New York Life Ins. Co.* v. *Gamer*, 303 U.S. 161, 171 (1938); *Fidelity Mutual Life Ass'n* v. *Mettler*, 185 U.S. 308, 317 (1902). It makes no difference that a civil proceeding is "penal" in nature. As this Court held in *United States* v. *Regan*, 232 U.S. 37, 48-50 (1914), in penalty proceedings "the true measure of persuasion is * * * the preponderating weight of the evidence." See also *United States* v. *Ward*, No. 79-394 (June 27, 1980), slip op. 5-6.

[16] See *Mihara* v. *Dean Witter & Co.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 97,508 at 97,662 (9th Cir. 1980); *SEC* v. *Savoy Industries, Inc.*, 587 F.2d 1149, 1168-1169 (D.C. Cir. 1978), cert. denied, 440 U.S. 913 (1979); *SEC* v. *Gilbert*, 79

in Commission actions to enjoin violations of the registration and antifraud provisions of the federal securities laws has been expressly approved by this Court. See *SEC* v. *C.M. Joiner Leasing Corp.*, 320 U.S. 344, 355 (1943). As the Court held in *Joiner*, "[w]here * * * proof is offered in a civil action, as here, a preponderance of the evidence will establish the case * * *."[17]

Very weighty interests—interests at least as substantial as the economic interests asserted by petitioner—are customarily adjudicated in civil proceedings under the preponderance of the evidence standard. No one has ever doubted that in a class action for treble damages brought under the antitrust laws, or in a corporate divestiture proceeding brought under the Federal Trade Commission Act, or a school desegregation case brought under the Fourteenth Amendment, the standard of proof is the preponderance of the evidence. Indeed, the decisions of this Court recognize that the preponderance of the evidence standard governs even in certain phases of criminal proceedings that may be fundamental to the

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F.R.D. 683, 686 (S.D.N.Y. 1978); *University Hill Foundation* v. *Goldman, Sachs & Co.*, 422 F. Supp. 879, 897 (S.D.N.Y. 1976); *Ronson Corp.* v. *Liquifin Aktiengesellschaft*, 370 F. Supp. 597, 602 (D.N.J.), aff'd, 497 F.2d 394 (3d Cir.), cert. denied, 419 U.S. 870 (1974).

[17] The present enforcement case was brought as an administrative proceeding before the Commission. The Commission is also authorized by statute to bring enforcement cases as injunctive actions in federal court, and may determine, in its discretion, the forum or forums in which to proceed. See Section 20(b) of the Securities Act, 15 U.S.C. 77t(b); Section 21(d) of the Securities Exchange Act, 15 U.S.C. 78u(d); Section 42(e) of the Investment Company Act, 15 U.S.C. 80a-41(e); Section 209(e) of the Investment Advisers Act, 15 U.S.C. 80b-9(e). An injunction restrains future unlawful conduct. If it appears that an appropriate sanction in the public interest would be the temporary or indefinite removal of a person from a position of trust in the securities industry, an administrative proceeding is the appropriate vehicle.

outcome of the litigation. For example, the voluntariness of a confession need be shown only by a preponderance of the evidence. See *Lego* v. *Twomey*, 404 U.S. 477 (1972).

The reason for this is plain. The preponderance standard insures that the adjudication rests on the most likely and probable view of the facts.[18] Applying a higher standard, such as the clear and convincing evidence standard, would mean that even though the party seeking a remedy had established that it was more likely than not that each and every prerequisite for the remedy was satisfied, the remedy must be denied if "clear and convincing" evidence was not available. As Professor Davis has recently observed, this is "inconsistent with accuracy." 2 *Administrative Law Treatise* 319 (2d ed. 1979). Such a result should be avoided since "the function of legal process is to minimize the risk of erroneous decisions." *Addington* v. *Texas*, *supra*, 441 U.S. at 425; accord, *Greenholtz* v. *Nebraska Penal Inmates*, 442 U.S. 1, 13 (1979).

In sum, acceptance of petitioner's claim in this case would interject serious inaccuracy in the administrative process. As we demonstrate below, it would also conflict with elementary considerations of fairness.

B. *Use of the Traditional Preponderance of the Evidence Standard is Required by Considerations of Fairness*

At bottom, petitioner's argument is that even though his proposed standard of proof would *increase* the total number of decisional errors, it should be adopted because

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[18] "[W]e want the correct result as often as possible and that means that preponderance of the evidence is only 50% plus. Imposing a greater disadvantage [on one party] would tend to cause more incorrect decisions than correct ones." Winter, *The Jury and the Risk of Nonpersuasion*, 5 Law & Soc. Rev. 335, 337 (1970-1971). See also Ball, *The Moment of Truth: Probability Theory and Standards of Proof*, 14 Vand. L. Rev. 807, 816-817 (1961).

it reduces the likelihood of a particular kind of error—incorrect decisions that are adverse to investment advisers. According to this argument, it is appropriate that investors bear a disproportionate risk of error because investment advisers have a substantial economic stake in continuing their business operations and avoiding sanctions (Br. 5, 15). This line of argument, however, stands the traditional concept of fiduciary duty on its head and runs counter to the basic purpose of the federal securities laws. Moreover, the argument ignores the fact that fairness to investment advisers is assured by the comprehensive procedural safeguards prescribed by Congress and the Commission in cases of this kind.

1. Under the analysis of *Addington* v. *Texas*, *supra*, 441 U.S. at 423-427, selection of the appropriate standard of proof requires a balancing of the individual interest and the interest sought to be protected by the government. The Court noted in *Addington* that "the individual should not be asked to share equally with society the risk of error when the possible injury to the individual is significantly greater than any possible harm to the state" (*id.* at 427). However, when both sides to the controversy have approximately equal interests in avoiding errors, they should "share the risk of error in roughly equal fashion" (*id.* at 423). The Court also noted that "standards of proof are important for their symbolic meaning as well as for their practical effect" (*id.* at 426).

In this case, it is not difficult to identify the correct balance of interests. Petitioner is a fiduciary and the proceeding against him seeks to protect his beneficiaries against continuing deception and flagrant disregard of legal requirements. The fiduciary principle requires that the interests of petitioner's beneficiaries come first. This is the substance of the common law of fiduciary duty [19] and is also basic to the federal securities laws.[20] In short,

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[19] See Scott, *The Fiduciary Principle*, 37 Calif. L. Rev. 539, 540 (1949).

[20] Congress declared in Section 1(b) of the Investment Company Act, 15 U.S.C. 80a-1(b), that the public interest is

considerations of fairness strongly support use of the traditional preponderance of the evidence standard in this context. Indeed, application of that standard to a fiduciary charged with self-dealing is generous. Traditionally in such cases the fiduciary bears the burden of proof (see page 32, *infra*). Imposition of a clear and convincing evidence standard here, which would create special evidentiary protections for investment advisers at the expense of their beneficiaries, would undermine the purpose of the federal securities laws and convey a wholly inappropriate "symbolic meaning" to investors and securities professionals alike. *Addington* v. *Texas*, *supra*, 441 U.S. at 426.[21]

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adversely affected when investment companies "are organized, operated, managed, or their portfolio securities are selected, in the interest of directors, officers, investment advisers, depositors, or other affiliated persons thereof, * * * rather than in the interest of all classes of such companies' security holders." Congress there also declared that it is contrary to the public interest to deny investors in investment companies "adequate, accurate, and explicit information, fairly presented, concerning the character of such securities and the circumstances, policies, and financial responsibility of such companies and their management * * *." Moreover, Congress intended Commission administrative proceedings to be prophylactic proceedings to ensure adherence to high standards of integrity. See *Blaise D'Antoni & Associates, Inc.* v. *SEC*, 289 F.2d 276, 277 (5th Cir.), rehearing denied, 290 F.2d 688, cert. denied, 368 U.S. 899 (1961); *Associated Securities Corp.* v. *SEC*, 283 F.2d 773, 775 (10th Cir. 1960). In this context, "broad discretionary powers in the [Commission] 'have been found practically essential.'" *Superintendent of Insurance* v. *Bankers Life & Cas. Co.*, 404 U.S. 6, 12 (1971). As this Court has emphasized, the "federal fiduciary standards" that govern the conduct of investment advisers were intended by Congress to be "enforceable fiduciary obligations." *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, *supra*, 444 U.S. at 17.

[21] Since the trier of fact here is a government agency rather than a lay jury, there is no need to impose a clear

Turning from legal principle to the respective economic interests in this case, it is also plain that the interests of investment advisers do not outweigh those of public investors. Petitioner undoubtedly has a strong interest in avoiding an erroneous factual determination that could lead to his debarment. But that interest scarcely outweighs the interest of public investors—who at one point entrusted petitioner with $250 million—in obtaining an accurate evaluation of the fitness of their fiduciary to continue in his position of trust. As the court of appeals explained (Pet. App. 26): "The public interest in high standards of conduct in the securities business is a great one." In these circumstances, petitioner can hardly complain that the law requires him to "share the risk of error in roughly equal fashion" (441 U.S. at 423).

As the court of appeals observed, there is a substantial risk that the investing public would be inadequately protected under a clear and convincing evidence standard (Pet. App. 26). Contrary to the sugestion in petitioner's brief that application of the more stringent standard would not significantly impede the enforcement of the securities laws (Br. 8-10), the Commission would not be likely to expend its limited resources in initiating meritorious cases in which it was possible that clear and convincing evidence would not be available. And, in those cases that were brought, the Commission would be forced to withhold sanctions needed to protect investors even though every prerequisite for relief was established by a fair preponderance of the evidence, should that evidence not clearly and convincingly show each required element. In this context, the potential harm to petitioner is not

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and convincing evidence standard to impress upon the agency the importance of the proceeding. In fact, the Commission expressly recognized the serious consequences of the proceeding and the need for procedural fairness: "Though these proceedings are not criminal, they are intensely serious. And we take them very seriously indeed" (Supp. App. 105-106 n.91).

"significantly greater" than the harm to the investing public (*Addington* v. *Texas*, *supra*, 441 U.S. at 427), and the traditional preponderance of the evidence standard accordingly applies. See Comment, *Scope of Review or Standard of Proof—Judicial Control of SEC Sanctions*, 93 Harv. L. Rev. 1845, 1854 (1980).[22]

2. Petitioner's claim that this Court should impose an extraordinary standard of proof to promote fairness is particularly untenable in view of the broad range of procedural safeguards that are afforded to respondents in administrative proceedings before the Commission. In the present case, for example, petitioner had a full hearing, was represented by sophisticated counsel, and exercised his right to cross-examine and confront opposing witnesses. He received the benefit of the imposition on the Commission's staff of the burden of proving that he willfully violated the federal securities laws. He had the right to testify in his own behalf—which he chose not to exercise—and to present other evidence in his defense. He appealed his case to the Commission and received an independent review of the factual record. He also utilized his right to brief the legal and factual issues in the case and

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[22] Vigorous government enforcement of the federal securities laws to protect the clients of investment advisers is particularly important in view of the limited availability of private remedies. See, *e.g.*, *Transamerica Mortgage Advisors, Inc.* v. *Lewis*, *supra*. The economic consequences of lax enforcement in this area can scarcely be overstated. According to estimates prepared in connection with the Commission's budget submission to Congress for the fiscal year ending September 30, 1982, assets currently under advisement by registered investment advisers total approximately $600 billion. Evidentiary rules that would prevent the Commission from disciplining dishonest fiduciaries in this industry would subvert the congressional purpose to " 'achieve a high standard of business ethics * * * in every facet of the securities industry.' " *United States* v. *Naftalin*, 441 U.S. 768, 775 (1979); *SEC* v. *Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 186-187 (1963).

present oral argument. Following the Commission's decision, he obtained judicial review that afforded him a renewed opportunity to contest the substantiality of the evidence, the propriety of the Commission's procedures, the correctness of the Commission's interpretation of the federal securities laws, and the sufficiency of the Commission's justification for the sanctions imposed.

This extended hearing procedure guaranteed the accuracy and fairness of the ultimate result. As Justice Frankfurter observed in his concurring opinion in *Joint Anti-Fascist Refugee Committee* v. *McGrath*, 341 U.S 123, 171-172 (1951): "No better instrument has been devised for arriving at truth than to give a person in jeopardy of serious loss notice of the case against him and opportunity to meet it." While the decisions of this Court confirm that "some form of hearing is required before an individual is finally deprived of a property interest" (*Mathews* v. *Eldridge*, 424 U.S. 319, 333 (1976)), the procedural requirements in such a hearing are "flexible" (*id.* at 334). This Court has recognized that "[a]t some point the benefit of an additional safeguard to the individual affected by the administrative action * * * may be outweighed by the cost" (*id.* at 348). "All that is necessary is that the procedures be tailored, in light of the decision to be made, to 'the capacities and circumstances of those who are to be heard,' * * * to insure that they are given a meaningful opportunity to present their case" (*id.* at 349). See *Arnett* v. *Kennedy*, 416 U.S. 134, 155 (1974) (dismissal of federal employee); *Goldsmith* v. *United States Board of Tax Appeals*, 270 U.S. 117, 123 (1926) (denial of admission to practice and disbarment of accountants). See also *Greenholtz* v. *Nebraska Penal Inmates*, *supra*, 442 U.S. at 12-13, noting that due process "is flexible and calls for such procedural protections as the particular situation demands."

In sum, petitioner had the opportunity to assure that the determination in this case was not based on a mistaken understanding of the facts. The extensive pro-

cedural protections granted to him resulted in a disposition that was both fair and accurate. His claim that, in addition to these procedural safeguards, he was entitled to a standard of proof that would distort the accuracy of the fact-finding process is an extravagant assertion that finds no support in the requirements of the Due Process Clause or the federal securities laws.[23]

C. *This Proceeding Does Not Involve a Constitutional Right or Extraordinary Interest That Would Dictate Use of a Higher Standard of Proof*

As previously noted, this Court's decisions recognize that the fair preponderance of the evidence standard governs in most civil cases, including civil cases involving allegations of fraud under the federal securities laws and

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[23] Under the Securities Exchange Act, national securities exchanges and national securities associations, in addition to the Commission, are authorized to conduct proceedings to resolve charges that securities industry personnel have violated the securities laws, including the antifraud provisions, and to impose sanctions, including suspension or debarment from positions in the industry. The legislative history of the 1975 Amendments to the Securities Exchange Act, Pub. L. No. 94-29, 89 Stat. 97, demonstrates that Congress deliberately prescribed for these disciplinary hearings only those procedures basic to "fundamental standards of due process." S. Rep. No. 94-75, 94th Cong., 1st Sess. 29 (1975). A requirement that self-regulatory bodies conducting disciplinary proceedings apply a standard of proof more stringent than the traditional preponderance of the evidence was not one of the requirements that Congress deemed necessary to satisfy due process. Rather, self-regulatory organizations are required to lodge specific written charges; give notice of those charges; provide an opportunity to defend; compile a record; and specify in any adverse determination the acts that constitute the violation, the statutory provision violated, the sanction imposed, and the reasons therefor. See Sections 6(d)(1) and 15A(h)(1) of the Securities Exchange Act, 15 U.S.C. 78f(d)(1) and 78o-3(h)(1). See also 2 K. Davis, *Administrative Law Treatise* 325-328, 499-504, 509-512 (2d ed. 1979).

even civil cases seeking to impose substantial penalties on those who violate the law. See pages 17-19, *supra;* see also *McCormick on Evidence* § 399 (2d ed. 1972). Those exceptional situations in which a higher standard has been employed differ fundamentally from the present case and highlight the inappropriateness of using a clear and convincing evidence standard here. For example, the First Amendment rights of newspapers demand proof by clear and convincing evidence before a publisher may be found liable for reckless or knowing defamation. *New York Times Co.* v. *Sullivan*, 376 U.S. 254, 280, 285-286 (1964). Plainly, the public interest in removing faithless trustees far exceeds the public interest in providing private compensation in libel cases. Similarly, clear and convincing evidence is required before an individual is stripped of personal freedom and confined indefinitely in a mental institution (*Addington* v. *Texas*, *supra*), and before an individual can be forced to endure the "drastic deprivations" of deportation (*Woodby* v. *INS*, 385 U.S. 276, 285 (1966)). The effect on petitioner of indefinite debarment from a segment of the securities industry cannot be compared to the drastic deprivations in those cases. Nor can the compelling societal interest in obtaining a correct evaluation of the honesty of a trustee managing hundreds of millions of dollars of other people's money be compared to the societal interest in expelling an individual alien or committing a citizen to a mental institution.

This Court's latest pronouncement on the clear and convincing evidence standard demonstrates that there is no merit to petitioner's claim that the severity of the sanction against him requires such a standard of proof. In *Vance* v. *Terrazas*, No. 78-1143 (Jan. 15, 1980), slip op. 13-14, this Court held that the Due Process Clause does not require the clear and convincing evidence standard even when the proceeding has a potential result as

harsh as expatriation. The Court explained in *Terrazas* that, while "in criminal and involuntary commitment contexts we have held that the Due Process Clause imposes requirements of proof beyond a preponderance of the evidence," expatriation proceedings "are civil in nature and do not threaten a loss of liberty." *A fortiori*, the interest of petitioner in maintaining his position in the securities industry is not so compelling as to require an extraordinary standard of proof. Petitioner's assertion that his right to pursue his "chosen occupation" is at risk (Br. 8) is far less weighty than Terrazas' assertion that his right to remain a United States citizen was at risk.

The Commission's order in this case bars petitioner from future association with investment advisers and investment companies. He has profitably engaged in that occupation in the past but repeatedly has failed to maintain the standards of honesty that are the preconditions for retaining his position of trust. See generally *Arnett* v. *Kennedy*, *supra*, 416 U.S. at 151-157. The sanction imposed in this case can be modified by the Commission if petitioner establishes that it is no longer needed to protect the public interest (see note 37, *infra*).

Imposition by this Court of an extraordinary standard of proof in the present case would have a fundamentally unsettling effect on civil litigation in general and administrative proceedings in particular. In most important cases, arguments can be made that the proceeding involves a potential "stigma" (for example, a case of deceptive advertising under the Federal Trade Commission Act), that the proceeding threatens loss of the right to pursue one's "chosen occupation" (for example, the discharge of a federal employee based on dishonest acts or the revocation of a pilot's license based on reckless conduct), or that the proceeding involves significant "financial losses" (for example, a civil divestiture suit brought by the Department of Justice). These considerations do not, however, give rise to the special concern

for personal liberty or protection of fundamental rights that has led the Court to require clear and convincing evidence in past cases. Indeed, even where "civil suits involve the proof of acts which expose the party to a criminal prosecution * * * proof by a reasonable preponderance of the evidence is sufficient." *United States* v. *Regan*, 232 U.S. 37, 49 (1914), cited with approval in *United States* v. *Ward*, No. 79-394 (June 27, 1980), slip op. 5-6.

D. *A Higher Standard of Proof is not Required Simply Because This Proceeding Involves Charges of Violations of the Antifraud Provisions of the Federal Securities Laws*

Petitioner also argues (Br. 15, 24) that clear and convincing evidence is required because he was charged with violating antifraud provisions of the federal securities laws. That argument is meritless for reasons that already have been mentioned. This Court has held that a "preponderance of the evidence" suffices in a civil proceeding alleging antifraud violations. See *SEC* v. *C.M. Joiner Leasing Corp.*, *supra*, 320 U.S. at 355. There is, moreover, a still more fundamental defect in petitioner's argument. This proceeding presents no analogy to a common law fraud action. This is a statutory proceeding designed to protect investors against future harm. Finally, even if common law fraud cases were relevant here, the better considered decisions in that context recognize that the preponderance of the evidence standard governs.

1. The antifraud provisions of the federal securities laws are not coextensive with common law doctrines of fraud and deceit. See generally *Blue Chip Stamps* v. *Manor Drug Stores*, 421 U.S. 723, 744-745 (1975). Congress enacted the federal securities laws to remedy inadequacies in the common law. "A fundamental purpose, common to [the federal securities] statutes, was to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." *SEC* v. *Cap-*

ital Gains Research Bureau, Inc., supra, 375 U.S. at 186. Far from limiting its protections to those provided at common law, the Investment Advisers Act reflects " 'a congressional intent to eliminate, or at least to expose, all conflicts of interest which might incline an investment adviser—consciously or unconsciously—to render advice which was not disinterested.' " *Aaron* v. *SEC,* No. 79-66 (June 2, 1980), slip op. 11-12, quoting *SEC* v. *Capital Gains Research Bureau, Inc., supra,* 375 U.S. at 191-192.

In *Capital Gains,* an injunctive action brought by the Commission against an investment adviser who had committed antifraud violations, the defendants argued that the Commission must prove the violations by clear and convincing evidence. A panel of the court of appeals accepted that argument. *SEC* v. *Capital Gains Research Bureau, Inc.,* 300 F.2d 745, 747 (2d Cir. 1961). While this Court did not address that specific issue when it reversed the decision of the court of appeals, it rejected the entire premise on which the argument was based—*i.e.,* that the antifraud provisions of the federal securities laws, particularly those in the Investment Advisers Act, are circumscribed by rigid common law fraud doctrines. The Court explained (375 U.S. at 194-195) (emphasis supplied):

> Courts have imposed on a fiduciary an affirmative duty of "utmost good faith, and full and fair disclosure of all material facts," as well as an affirmative obligation "to employ reasonable care to avoid misleading" his clients. * * *
>
> We cannot assume that Congress, in enacting legislation to prevent fraudulent practices by investment advisers, was unaware of these developments in the common law of fraud. Thus, even if we were to agree with the courts below that Congress had intended, in effect, to codify the common law of fraud in the Investment Advisers Act of 1940, *it would be logical to conclude that Congress codified the common law "remedially" as the courts had adapted it*

> *to the prevention of fraudulent securities transactions by fiduciaries, not "technically" as it has traditionally been applied in damage suits between parties to arm's-length transactions involving land and ordinary chattels.*[24]

In an earlier case, the D.C. Circuit correctly rejected the argument that common law doctrines of fraud apply in administrative proceedings instituted by the Commission to revoke the registration of broker-dealers who violate the antifraud provisions of the federal securities laws. To accept such an argument, the court noted, "would be to adopt the fallacious theory that Congress enacted existing securities legislation for the protection of the broker-dealer rather than for the protection of the public." *Norris & Hirshberg, Inc.* v. *SEC*, 177 F.2d 228, 233 (D.C. Cir. 1949).

These considerations apply here and require rejection of petitioner's argument that clear and convincing evidence must be presented in an administrative proceeding of this kind.

2. Petitioner's reliance on common law fraud decisions is also unavailing because the better considered common law authorities approve the preponderance of the evidence standard rather than the clear and convincing evidence standard. As this Court observed in *SEC* v. *Capital Gains Research Bureau, Inc.*, *supra*, 375 U.S. at 194:

> There has also been a growing recognition by common-law courts that the doctrines of fraud and deceit which developed around transactions involving land and other tangible items of wealth are ill-suited to the sale of such intangibles as [investment] advice and securities, and that, accordingly, the doctrines must be adapted to the merchandise in issue.

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[24] Accord, *Hughes* v. *SEC*, 174 F.2d 969 (D.C. Cir. 1949); *Charles Hughes & Co.* v. *SEC*, 139 F.2d 434 (2d Cir.), cert. denied, 321 U.S. 786 (1943); see 3 L. Loss, *Securities Regulation* 1435 (2d ed. 1961).

Thus, some state courts have declined to apply a more stringent standard of proof in cases involving allegations of fraud when securities were involved or when violations of state blue sky laws were at issue.[25] Moreover, it is generally recognized that a high standard of proof is not appropriate in cases involving claims of breach of fiduciary duty. Once a fiduciary relationship and self-dealing by the fiduciary have been shown, the burden shifts to the fiduciary to prove that the transaction was lawful and that he has not abused the relationship.[26]

Furthermore, even outside the area of securities fraud and fraud by fiduciaries, "[t]he policy of placing such a special burden [the clear and convincing evidence requirement] on one who claims to be the victim of fraud is debatable." *McCormick on Evidence, supra,* § 340, at 797 n.74. The better reasoned state court decisions hold that there is no sound reason for according special evidentiary

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[25] See, *e.g., S&F Supply Co.* v. *Hunter,* 527 P.2d 217, 220-221 (Utah 1974) (to obtain redress under state antifraud provisions plaintiff must show elements of the violation by a preponderance of the evidence). See also 11C (Part 2) H. Sowards & N. Hirsch, *Business Organizations, Blue Sky Regulation* § 6.01, at 6-4 to 6-5 (1979) (footnote omitted):

> The nature of the blue sky laws virtually demands that they be liberally interpreted in order to effectuate the antifraud purposes. This * * * has altered the principle governing the weight of evidence in civil cases. * * * [F]raud actions brought under the blue sky laws have been decided in some states according to a fair preponderance of the evidence, which has been described as a probability of belief by triers of fact.

[26] *Garrett* v. *Moore-McCormick Co.,* 317 U.S. 239, 247 (1942); *Geddes* v. *Anaconda Copper Mining Co.,* 254 U.S. 590, 599 (1921); *Francois* v. *Francois,* 599 F.2d 1286, 1290-1293 (3d Cir. 1979), cert. denied, No. 79-5548 (Jan. 7, 1980); *Nedd* v. *UMW,* 556 F.2d 190, 210 (3d Cir. 1977), cert. denied, 434 U.S. 1013 (1978); *Ohio Drill & Tool Co.* v. *Johnson,* 498 F.2d 186, 195 (6th Cir. 1974).

benefits to those accused of fraud at the expense of those claiming to be their injured victims, and they have explicitly adhered to the preponderance of the evidence standard of proof when fraud is at issue.[27] Likewise, a substantial number of authorities, including those available at the time when the federal securities laws were enacted, acknowledge that the preponderance of the evidence standard applies in most civil actions involving allegations of fraud.[28] As one commentator explained:

> Parties engaged in fraudulent schemes always resort to the use of legal forms, as far as possible, to cover their purposes; and hence it would often be expecting

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[27] ARKANSAS: *Ray Dodge, Inc.* v. *Moore*, 251 Ark. 1036, 1041, 479 S.W.2d 518, 521-522 (1972); CALIFORNIA: *Liodas* v. *Sahadi*, 562 P.2d 316, 321-323, 137 Cal. Rptr. 635, 639-643 (1977); COLORADO: *Goodfellow* v. *Kattnig*, 533 P.2d 58, 60 (Colo. App. 1975); FLORIDA: *Rigot* v. *Bucci*, 245 So.2d 51, 53 (1971); *Blaeser Development Corp.* v. *First Federal Savings & Loan Ass'n*, 375 So.2d 1118 (Fla. App. 1979); INDIANA: *Grissom* v. *Moran*, 154 Ind. App. 419, 427, 290 N.E.2d 119, 123 (1972); MONTANA: *Cowan* v. *Westland Realty Co.*, 162 Mont. 379, 383, 512 P.2d 714, 716 (1973); NEW JERSEY: *Medivox Productions, Inc.* v. *Hoffmann-LaRoche, Inc.*, 107 N.J. Super. 47, 69, 256 A.2d 803, 814-815 (1969); OHIO: *Household Finance Corp.* v. *Altenberg*, 5 Ohio St.2d 190, 214 N.E.2d 667 (1966); RHODE ISLAND: *Smith* v. *Rhode Island Co.*, 39 R.I. 146, 153-154, 98 A. 1, 4 (1916); SOUTH DAKOTA: *General Electric Credit Corp.* v. *M.D. Aircraft Sales, Inc.*, 266 N.W.2d 548, 550 (1978); VERMONT: *In re Delligan's Estate*, 111 Vt. 227, 234-235, 13 A.2d 282, 287 (1940). See also *Jensen* v. *Sohler*, 601 F.2d 353, 354-355 (8th Cir. 1979).

[28] See, *e.g.*, 20 Am. Jur., *Evidence* §§ 1248, 1255 (1939); 24 Am. Jur., *Fraud and Deceit* §§ 278, 279 (1939); Annot., 62 A.L.R. 1449 (1929) (majority rule requires a preponderance of the evidence to establish fraudulent, dishonest or criminal misappropriation of property); Annot., 33 L.R.A. (N.S.) 836 (1911). See also 2 T. Cooley, *Treatise on the Law of Torts* § 349, at 552-554 (4th ed. 1932).

> too much to look for clear and undisputed evidence of fraud. The law therefore does not require it * * *. *It is settled law that, upon the trial of a civil action in which the claim or defence is based on alleged fraud, the issue may be determined in accordance with the preponderance or weight of evidence,* except in cases of resulting trusts arising on verbal agreements to buy for another.

M. Bigelow, *The Law of Fraud and the Procedure Pertaining to the Redress Thereof* 474 (1877) (footnotes omitted, emphasis supplied).

3. While decisions in non-statutory fraud cases involving private parties have sometimes employed a clear and convincing evidence standard, particularly when certain types of equitable relief have been sought,[29] the use of the higher standard generally has rested on historical considerations that have no pertinence here. The practice of requiring a more stringent standard of proof appears to have arisen in actions in which the chancellor was requested to grant relief on claims that were unenforceable at law for failure to comply with the Statute of Frauds or the Statute of Wills, and was subsequently applied in actions seeking to set aside or alter the terms of written instruments. A higher standard of proof was employed in such cases because they were believed to involve special dangers that claims might be fabricated. See Note, *Appellate Review in the Federal Courts of Findings Requiring More than a Preponderance of the Evidence,* 60 Harv. L. Rev. 111, 112 (1946). The concern of the courts in these circumstances was the need to protect the sanctity of written instruments and the reliance placed upon such documents. See *Rice-Stix Dry Goods Co.* v. *Montgomery,* 164 Ark. 161, 171, 261 S.W. 325, 329 (1924), quoted in *McCormick on Evidence, supra,* § 340, at 797 n.74 (emphasis supplied):

> [I]n actions at law one who has the burden of proof to establish fraud meets the requirements of the rule

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[29] See 9 J. Wigmore, *Evidence* § 2498 (3d ed. 1940).

> when he proves the fraud only by a preponderance of the evidence. The same rule likewise prevails in equity, *except in those cases where the rescission, cancellation, or reformation of a writing for fraud of one party and mistake of the other, or mutual mistake, is the relief sought,* in which latter case, as we have stated, the proof of fraud or mistake must be clear, unequivocal, and decisive.[30]

Early decisions of this Court express similar concerns in determining the standard of proof needed for overturning land patents granted by the United States.[31]

The concerns expressed in these cases have no relevance here. Regulation under the securities laws of the conduct of investment advisers poses no danger to the sanctity of written documents or official acts. More fundamentally, imposition of a standard of proof borrowed from inapposite common law cases would undermine the important purposes of the federal securities laws, which Congress enacted to remedy inadequacies in common law protections. It is inconceivable that Congress would have intended to distort the fact-finding process under these statutes so that fiduciaries charged with fraud could retain their position of trust even though the preponder-

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[30] Accord, *Ray Dodge, Inc.* v. *Moore,* 251 Ark. 1036, 1041, 479 S.W.2d 518, 521 (1972) ("Clear and convincing evidence of fraud is required to cancel or reform a solemn writing, but not to establish fraud in obtaining a contract by fraudulent misrepresentation."); *Household Finance Corp.* v. *Altenberg,* 5 Ohio St.2d 190, 214 N.E.2d 667 (1966); *In re Delligan's Estate,* 111 Vt. 227, 234-235, 13 A.2d 282, 287 (1940). This same rationale, *i.e.,* the protection of written documents, is apparent in most of the instances in which Wigmore states that " 'clear and convincing proof' is commonly applied." 9 J. Wigmore, *Evidence* § 2498 (3d ed. 1940); see Note, *supra,* 60 Harv. L. Rev. at 112.

[31] See, *e.g., United States* v. *Budd,* 144 U.S. 154, 161-162 (1892); *Maxwell Land-Grant Case,* 121 U.S. 325, 382 (1887). See also *United States* v. *American Bell Telephone Co.,* 167 U.S. 224, 240-241 (1897) (patent on invention granted by the United States).

ating weight of the evidence showed that every prerequisite supporting their removal had been established.[32]

E. *A Higher Standard of Proof is not Required by the Fact That This is a Disciplinary Proceeding*

Petitioner also argues that he has a "right" to pursue his "chosen occupation" (Br. 8), and, like an attorney subject to disbarment, cannot be deprived of that right without proof of misconduct by clear and convincing evidence (Br. 24).

However, disciplinary proceedings brought by the Commission against investment advisers and other securities industry fiduciaries bear little resemblance to disciplinary proceedings against lawyers brought by state bar authorities. Commission disciplinary proceedings are an important factor in the regulation of the public securities markets. Investment advisers, unlike lawyers, may enter into this sensitive industry without graduate education, without examination by governmental authorities to establish their knowledge in the field, and without examination by any committee on fitness and character. In contrast to the legal profession, "anyone can become registered to give [investment] advice to others, regardless of whether that person has any prior education, training, or experience in financial matters, and regardless of whether he is financially able to perform the services contracted for." [33] Thus, "[u]nder the law

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[32] Congress' views on the need to avoid standards of proof that frustrate investor protection can be discerned from Sections 11(b) and 12(2) of the Securities Act, 15 U.S.C. 77k(b), 77*l*(2). Under those antifraud provisions, persons charged by investors with misrepresentation must bear the burden of proof to establish their lack of culpability.

[33] S. Rep. No. 94-910, 94th Cong., 2d Sess. 2 (1976). The only steps a person need take to register as an investment adviser are to file an application and pay a filing fee. See 15 U.S.C. 80b-3(c)(1); 17 C.F.R. 275.203-3.

as it exists today, any person of any qualification or lack thereof can become a portfolio manager of vast sums of money." [34] This stands in sharp contrast to the case of the attorney who, "upon admission to the bar, [is] certified by the court to have then attained high moral and professional standards." *In re Little*, 40 Wash.2d 421, 430, 244 P.2d 255, 259-260 (1952). In light of this judicial certification, the court in *Little* stated that "[i]t is to be presumed that he has maintained [those standards] and has performed his duty as an officer of the court in accordance with his oath." *Ibid.*

In short, the ease of entry into the investment advisory field, which differs fundamentally from the legal profession, highlights the importance of enforcing federal fiduciary standards through administrative proceedings utilizing the standard of proof most consistent with an accurate evaluation of the evidence. This conclusion is reinforced by the fact that many jurisdictions recognize that the public interest requires use of the preponderance of the evidence standard in attorney disbarment proceedings.[35]

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[34] *Hearings on S. 2849 Before the Subcomm. on Securities of the Senate Comm. on Banking, Housing & Urban Affairs*, 94th Cong., 2d Sess. 76 (1976).

[35] ALABAMA: *Dodd* v. *Board of Commissioners*, 350 So.2d 700, 705 (1977); ALASKA: *In re Robson*, 575 P.2d 771, 776-777 (1978); ARKANSAS: *Hurst* v. *Bar Rules Committee*, 202 Ark. 1101, 1110, 155 S.W.2d 697, 701 (1941); HAWAII: *In re Trask*, 46 Hawaii 404, 410-411, 380 P.2d 751, 755 (1963); INDIANA: *In re Pawlowski*, 240 Ind. 412, 432-433, 165 N.E. 2d 595, 605 (1960); KENTUCKY: *Louisville Bar Ass'n* v. *Hubbard*, 282 Ky. 734, 742, 139 S.W.2d 773, 777 (1940); MASSACHUSETTS: *In re Mayberry*, 295 Mass. 155, 166-167, 3 N.E.2d 248, 253 (1936); MICHIGAN: *State Administrator* v. *Posler*, 390 Mich. 581, 213 N.W.2d 133 (1973); MISSOURI: *In re Duncan*, 541 S.W.2d 564, 568-569 (1976); NEW YORK: *Feola* v. *New York State Bar Ass'n*, 37 App. Div.2d 789, 324 N.Y.S.2d 654 (1971); OHIO: *Cleveland Bar*

Finally, although petitioner claims that he has a "right" to serve as an investment adviser, Congress has declared that he enjoys no life tenure. Like other trustees, he can be removed for dishonesty.[36] And the order of removal is properly continued until he establishes that his reinstatement is consistent with the public interest.[37]

F. *A Higher Standard of Proof is not Required Merely Because Circumstantial Evidence is Relied Upon*

Petitioner also argues (Br. 16-19) that reliance on inferential or circumstantial evidence to prove mental state in a proceeding of this kind makes the traditional preponderance of the evidence standard inappropriate.

Petitioner overstates the importance of circumstantial evidence in cases of this kind. Petitioner's violations, as evidenced by the repeated transfer of accounts from bank to bank, the loans, the nondisclosures, the failure to file timely reports, and the other conduct found by the Commission to have occurred in this case, were established by direct evidence. No inferential reasoning was required to prove this conduct.[38]

Ass'n v. *Fleck*, 172 Ohio St. 467, 469, 178 N.E.2d 782, 784 (1961), cert. denied, 369 U.S. 861 (1962); TEXAS: *Houtchens* v. *State*, 63 S.W.2d 1011, 1015 (Tex. App. 1933). See also Annot., 105 A.L.R. 984, 985 (1936).

[36] See II A. Scott, *Trusts* § 107, at 840-844 (1967) (a trustee "will be removed if his conduct is such as to show his unfitness to administer the trust"). See also III A. Scott, *Trusts* § 187.1, at 1509 (1967).

[37] See Pet. App. 28 n.17; Supp. App. 119 n.100; see also *Hanly* v. *SEC*, 415 F.2d 589, 598 (2d Cir. 1969); *Lawrence* v. *SEC*, 398 F.2d 276, 281 (1st Cir. 1968); Securities Exchange Act Release No. 11267, 6 S.E.C. Docket 346 (Feb. 26, 1975) ("application for relief from disqualification"); *In re Brick*, 8 S.E.C. Docket 240, 247-248 n.38 (1975).

[38] Where, as here, findings of violations are made under the antifraud provisions of Section 17(a) (2) and (3) of the Secu-

Moreover, partial reliance on circumstantial or inferential evidence does not require a higher standard of proof, since, as this Court has recognized, "[c]ircumstantial evidence is not only sufficient, but may also be more certain, satisfying and persuasive than direct evidence." *Michalic* v. *Cleveland Tankers, Inc.*, 364 U.S. 325, 330 (1960).[39] Indeed, this Court recognized the value of such proof in *SEC* v. *C. M. Joiner Leasing Corp.*, *supra*, 320 U.S. at 355, when it held that economic inducements surrounding the sale of leaseholds were circumstantially relevant in determining whether those instruments were securities. See also *TSC Industries, Inc.* v. *Northway, Inc.*, 426 U.S. 438, 463 & n.24 (1976) (fraudulent market manipulation may be proven "by circumstantial as well as direct evidence").

Of course, in cases of this kind the Commission must find, in addition to the elements of the underlying violation, that the conduct was "willful." But, contrary to petitioner's suggestion (Br. 17-19), the meaning of the willfulness requirement is not at issue here. The essential point is that willfulness, like any other relevant fact in an administrative proceeding, is subject to reli-

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rities Act and Section 206(2) of the Investment Advisers Act, proof of scienter is not required to establish the violations. *Aaron* v. *SEC*, *supra*; *Capital Gains Research Bureau, Inc.* v. *SEC*, *supra*. Thus, the primary element to be proven in the proceeding—the underlying violation of the securities laws—does not require proof of mental state.

[39] See also *Rogers* v. *Missouri Pacific R.R.*, 352 U.S. 500, 508 n.17 (1957); *Holland* v. *United States*, 348 U.S. 121, 139-140 (1954); *Rea* v. *Missouri*, 84 U.S. (17 Wall.) 532, 543 (1873); *Lukon* v. *Pennsylvania R.R.*, 131 F.2d 327, 329 (3d Cir. 1942) (circumstantial evidence "has probative value equal to that of testimonial evidence").

able proof under a preponderance standard. Indeed, a party concerned about the accuracy of the agency's determination as to willfulness is free to present evidence, including his own direct testimony, concerning that matter. Petitioner had the opportunity to provide such direct evidence, but declined to do so (Supp. App. 51). A party having direct evidence in his sole possession—but who refuses to divulge it—cannot complain of the agency's reliance on probative inferential evidence. See generally *Baxter* v. *Palmigiano*, 425 U.S. 308, 318-319 (1976); *Local 167, Int'l Brotherhood of Teamsters* v. *United States*, 291 U.S. 293, 298 (1934); *Proud* v. *CAB*, 357 F.2d 221, 223-224 (7th Cir. 1966).

In short, there is nothing unusual or improper about relying on circumstantial evidence to prove state of mind in a civil proceeding. This is a commonplace inquiry in federal courts and federal administrative agencies, and the task is traditionally performed pursuant to the preponderance of the evidence standard of proof.[40]

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[40] In *Vance* v. *Terrazas, supra,* slip op. 14, this Court approved the preponderance of the evidence standard in a case requiring proof of specific intent to relinquish citizenship. The Court noted that the government's duty to prove the state of mind element was "in itself a heavy burden" that militates *in favor* of using the preponderance standard of proof.

If petitioner were correct in asserting (a) that inferential and circumstantial evidence is inherently speculative and unreliable, and (b) that the government must present clear and convincing evidence of state of mind (Br. 19), then it would logically follow that the government could rarely (if ever) obtain an order to protect the public. If the respondent investment adviser—like petitioner—refused to provide "direct" testimony concerning his state of mind, then the only evidence in the case would be circumstantial evidence,

II. The Administrative Procedure Act Contemplates Use of the Preponderance of the Evidence Standard in Administrative Proceedings of This Kind

This Court recognized in *Vance* v. *Terrazas, supra,* that when Congress specifies a standard of proof, that legislative judgment ordinarily controls. The Court emphasized the "traditional powers of Congress to prescribe rules of evidence and standards of proof" (slip op. 13) and noted that "a congressional judgment * * * that the preponderance standard of proof provides sufficient protection" is entitled to deference (*id.* at 14).

While Congress has mandated a more stringent evidentiary standard than preponderance of the evidence in certain federal statutes,[41] it has not done so in the federal securities laws. Adjudicatory proceedings under those laws, however, are governed by Section 7(c) of the Administrative Procedure Act ("APA"), 5 U.S.C. 556(d).[42] Section 7(c) provides in pertinent part (emphasis supplied):

> Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof. * * * *A sanction may not be imposed or rule or order issued except* on consideration of the whole record or those parts thereof cited by a party and supported by and *in accordance with the reliable, probative, and substantial evidence.*[43]

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which, by petitioner's hypothesis, would be speculative and unreliable and insufficient under the clear and convincing standard of proof.

[41] See, *e.g.*, 8 U.S.C. 1448(a); 19 U.S.C. (Supp. II) 1592(e)(2); 25 U.S.C. (Supp. II) 1912(e); 38 U.S.C. 354(b).

[42] See Sections 5 and 7 of the APA, 5 U.S.C. 554(a) and 556(a); Sections 15(b)(4) and 15(b)(6) of the Securities Exchange Act, 15 U.S.C. 78*o*(b)(4) and 78*o*(b)(6); Sections 203(e) and 203(f) of the Investment Advisers Act, 15 U.S.C. 80b-3(e) and 80b-3(f); Section 9(b) of the Investment Company Act, 15 U.S.C. 80a-9(b).

[43] Section 7(c) is directed to two distinct questions—the type of evidence to be received (evidence that is separately

Nothing on the face of this statute suggests that Congress intended to apply the extraordinary "clear and convincing evidence" standard of proof. To the contrary, the words "reliable," "probative," and "substantial" show that Congress meant to endorse the traditional preponderance standard—the standard that produces adjudications in every case that are consistent with the most probable and likely factual inferences. In discussing Section 7(c), the House Report that accompanied the APA explained (H.R. Rep. No. 1980, 79th Cong., 2d Sess. 37 (1946) (emphasis supplied)):

> [W]here a party having the burden of proceeding has come forward with a prima facie and substantial case, he will prevail unless his evidence is discredited or rebutted. In any case the agency must decide "in accordance with the evidence." *Where there is evidence pro and con, the agency must weigh it and decide in accordance with the preponderance.*

See also the dissenting opinion of Justices Clark and Harlan in *Woodby* v. *INS*, *supra*, 385 U.S. at 288-289 n.1, which explains that the APA standard of "reliable, probative, and substantial" evidence has "traditionally been held satisfied when the agency decides on the preponderance of the evidence." The majority in *Woodby* did not disagree with that analysis.[44] Moreover, the same

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described in Section 7(c) as not "irrelevant, immaterial, or unduly repetitious") and the standard of proof that must be satisfied to support a sanction ("reliable, probative, and substantial evidence"). See H.R. Rep. No. 1980, 79th Cong., 2d Sess. 53 n.16 (1946).

[44] The majority in *Woodby* required a higher standard of proof in the deportation proceeding before the Court. However, that proceeding was not governed by the APA (see 385 U.S. at 287-288 (Clark, J., dissenting)). The majority concluded in *Woodby* that the Immigration and Nationality Act did not prescribe a standard of proof; instead, the Act prescribed a standard of judicial review. In these circumstances,

court that decided *Collins* and *Whitney* has also recognized that the APA prescribes the preponderance of the evidence standard.[45]

Enactment of the APA confirmed the use of the preponderance of the evidence standard that the Commission had applied in earlier cases.[46] Following the passage

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the Court held that it was appropriate for the judiciary to devise an appropriate standard of proof (385 U.S. at 284).

Unlike the Immigration Act, the APA has always contained a separate judicial review section designated as such. See Section 10(e), 5 U.S.C. 706. That provision is worded differently from Section 7(c). Both the language of Section 7(c) and its legislative history (see pages 41-42, *supra*) confirm that it prescribes a standard of proof.

[45] In *Sea Island Broadcasting Co.* v. *FCC*, 47 Ad. L.2d 831 (1980), the D.C. Circuit noted that "the 'preponderance of evidence' standard is the traditional standard in civil and administrative proceedings." The Court added: "It is the one contemplated by the APA, 5 U.S.C. 556(d)." *Id.* at 835 & n.6, citing H.R. Rep. No. 1980, 79th Cong., 2d Sess. 37 (1946). Although the court recognized that the administrative proceeding under review (a broadcast license revocation proceeding) was governed by the APA, it nevertheless concluded that the agency must apply the clear and convincing evidence standard. The court stated that, in its view, the proceeding was comparable to a broker-dealer disciplinary proceeding and therefore was governed by its earlier decisions in *Collins* and *Whitney*. In so ruling, the court made no attempt to justify its conclusion that the FCC must deviate from the statutory standard prescribed in the APA. 47 Ad. L.2d at 835-837.

[46] As early as 1938, the Commission had rejected the argument that in a proceeding to determine whether to suspend, expel or otherwise sanction a brokerage firm and its principals for, *inter alia*, manipulation of security prices in violation of Section 9 of the Securities Exchange Act, 15 U.S.C. 78i, a standard of proof greater than the preponderance of the evidence standard is required. *In re White*, 3 S.E.C. 466, 539, 540 (1938).

of the APA, the Commission considered the question anew in a proceeding leading to the revocation of the registration of a broker-dealer. *In re Pollisky*, 43 S.E.C. 458 (1967). In determining that a more stringent standard such as that applicable in deportation cases was inappropriate, the Commission relied on the analysis in *Woodby* v. *INS*, *supra*, and on the traditional interpretation of the language in Section 7(c) of the APA. 43 S.E.C. at 459-460; see also 43 S.E.C. 852, 861 (1968) (after remand). The Commission noted (*id.* at 460; footnotes omitted):

> While the Exchange Act does not address itself specifically to the question of what degree of proof is required in an administrative proceeding, the Administrative Procedure Act ("APA"), which is applicable to proceedings under the Exchange Act, does. Section 7(c) of the APA provides that no rule or order shall be issued by an administrative agency except as supported by "the reliable, probative and substantial evidence." The standard has traditionally been held to be satisfied when the agency decides on the "preponderance of the evidence."

In accordance with Section 7(c) of the APA, the Commission repeatedly has employed or approved the use of the preponderance standard in administrative proceedings brought against securities industry personnel.[47]

In sum, this Court need not engage in an analysis of the relative advantages of the "preponderance of the evi-

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[47] See, *e.g.*, *In re Seaton*, 18 S.E.C. Docket 400, 401 n.6 (1979), petition for review pending, No. 79-2317 (D.C. Cir.); *In re Decker*, 15 S.E.C. Docket 1342 (1978), petition for review pending, No. 78-2008 (10th Cir.); *In re Schultz*, 15 S.E.C. Docket 860 (1978), aff'd, 614 F.2d 561 (7th Cir. 1980); *In re Investors Research Corp.*, 14 S.E.C. Docket 1020, 1026 n.30 (1978), aff'd in part, remanded in part, [Current] Fed. Sec. L. Rep. (CCH) ¶ 97,526 (D.C. Cir. 1980); *In re Abbett, Sommer & Co.*, 44 S.E.C. 104, 113-114 (1969), aff'd, [1970-1971] Fed. Sec. L. Rep. (CCH) ¶ 92,813 (D.C. Cir. 1970),

dence" and "clear and convincing evidence" standards in this context. Congress has already done so and has chosen the preponderance standard.

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cert. denied, 401 U.S. 974 (1971); *In re Cea*, 44 S.E.C. 8, 25 (1969); *In re Pollisky*, 43 S.E.C. 458 (1967), after remand, 43 S.E.C. 852, 860-861 & nn. 18-24 (1968); *In re DeMammos*, 43 S.E.C. 333, 337, aff'd, 23 Ad. L.2d 221 (2d Cir. 1967); *In re Underhill Securities Corp.*, 42 S.E.C. 689, 695 (1965). In certain situations subsequent to the D.C. Circuit's decision in *Collins*, the Commission has utilized the clear and convincing evidence standard in deference to the view of that court, which has venue of petitions for review of Commission orders. See, *e.g.*, 15 U.S.C. 80b-13(a).

Petitioner argues (Br. 26-27) that the fact that Congress has failed to enact legislation (in addition to the APA) that would approve use of the preponderance of the evidence standard in Commission proceedings "strengthens the inference" that Congress intended to require the clear and convincing evidence standard. Congressional intent cannot, however, be discerned from legislative inaction. *Boys Markets, Inc.* v. *Retail Clerks Local 770*, 398 U.S. 235, 241-242 (1970). See also *United States* v. *Board of Commissioners*, 435 U.S. 110, 135, 149 (1978); *NLRB* v. *Plasterers' Local 79*, 404 U.S. 116, 129-130 (1971). Furthermore, congressional action in this field was totally unnecessary following enactment of the APA in 1946. No circuit, except the D.C. Circuit within the last three years, has departed from the preponderance standard embodied in the APA (see notes 13-14, *supra*).

Petitioner also contends (Br. 25) that the silence of Congress as to a standard of proof in administrative disciplinary proceedings under the securities laws reflects an intention to adopt the clear and convincing evidence standard utilized in certain common law contexts. Petitioner points to nothing, however, which suggests that Congress had in mind the standard of proof used in those unrelated situations. See generally *TVA* v. *Hill*, 437 U.S. 153, 192 (1978).

III. The Decision Whether to Employ a Standard of Proof Greater Than the Preponderance of the Evidence Standard is Properly a Matter of Commission Discretion in the Circumstances of This Case.

1. As we have demonstrated above, Section 7(c) of the APA prescribes a preponderance of the evidence standard of proof. But, even if the APA did not prescribe a standard of proof, the Commission's decision to utilize the preponderance standard should be upheld. Since neither the Due Process Clause nor any other statute requires proof by more than a fair preponderance of the evidence, the decision whether to apply a higher standard is a discretionary decision of the administrative agency.

As this Court explained in *Mathews* v. *Eldridge, supra,* 424 U.S. at 348-349 (an adjudicatory proceeding involving termination of disability benefits):

> We reiterate the wise admonishment of Mr. Justice Frankfurter that differences in the origin and function of administrative agencies "preclude wholesale transplantation of the rules of procedure, trial, and review which have evolved from the history and experience of courts." *FCC* v. *Pottsville Broadcasting Co.*, 309 U.S. 134, 143 (1940). * * * In assessing what process is due in this case, substantial weight must be given to the good faith judgments of the individuals charged by Congress with the administration of [the statute] that the procedures they have provided assure fair consideration of the * * * claims of individuals. * * * This is especially so where, as here, the prescribed procedures not only provide the [individual] with an effective process for asserting his claim prior to any administrative action, but also assure a right to an evidentiary hearing, as well as to subsequent judicial review, before the denial of his claim becomes final.

Later, in *Vermont Yankee Nuclear Power Corp.* v. *Natural Resources Defense Council,* 435 U.S. 519, 524 (1978), this Court noted in a rulemaking proceeding that the procedural safeguards prescribed in the APA are "the maximum procedural requirements which Congress

was willing to have the courts impose upon agencies * * *." Accordingly, "[a]gencies are free to grant additional procedural rights in the exercise of their discretion, but reviewing courts are generally not free to impose them if the agencies have not chosen to grant them." The Court added that "this Court has for more than four decades emphasized that the formulation of procedures was basically to be left within the discretion of the agencies to which Congress had confided the responsibility for substantive judgments" (*ibid.*). See also *Costle* v. *Pacific Legal Foundation*, No. 78-1472 (Mar. 18, 1980), slip op. 16.[48]

The Court observed in *Vermont Yankee* that administrative agencies " 'should be free to fashion their own rules of procedure and to pursue methods of inquiry capable of permitting them to discharge their multitudinous duties' " absent "constitutional constraints or extremely compelling circumstances." 435 U.S. at 543.[49] Neither of these restrictions is present here. *Vance* v. *Terrazas*, *supra*, slip op. 13-14, confirms that the Due Process Clause does not require clear and convincing evidence in this context. And petitioner has failed to show any "compelling" reason why the risk of error in this case should not be borne equally by himself and the investors who

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[48] This judicial deference "is an outgrowth of the congressional determination that administrative agencies and administrators will be familiar with the industries which they regulate and will be in a better position than federal courts or Congress itself to design procedural rules adapted to the peculiarities of the industry and the tasks of the agency involved." *FCC* v. *Schreiber*, 381 U.S. 279, 290 (1965).

[49] The appropriate standard of proof is a procedural matter that many agencies address in their own rules of practice. See 16 C.F.R. 3.51(b)(3) (Federal Trade Commission); 16 C.F.R. 1025.51(b) (Consumer Product Safety Commission); 18 C.F.R. 1.38(k)(2), 1.40(i)(2) (Federal Energy Regulatory Commission); 29 C.F.R. 101.10(b)(1) (National Labor Relations Board).

have entrusted him with their money. Under these circumstances, the administrative agency's decision to use the preponderance standard should be affirmed.[50]

2. That the standard of proof in Commission adjudicative proceedings is not greater than the preponderance of the evidence does not mean that parties are afforded inadequate protection from unfair or erroneous agency action. As the court of appeals correctly concluded (Pet. App. 27-28), such protection is properly achieved not by requiring the Commission to apply a higher standard of proof, but by meaningful judicial review pursuant to Section 10(e) of the Administrative Procedure Act, 5 U.S.C. 706. See also 15 U.S.C. 78y(a), 80a-42(a), and 80b-13(a). Section 10(e) permits a reviewing court to set aside agency action that is arbitrary or capricious or that is not supported by substantial evidence.[51] Mean-

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[50] In imposing a clear and convincing evidence standard in cases of this kind, the D.C. Circuit's *Collins* decision erroneously relied on this Court's statement in *Woodby* v. *INS*, *supra*, that the standard of proof "is the kind of question which has traditionally been left to the judiciary to resolve." 562 F.2d at 824 (quoting 385 U.S. at 185). As previously noted (see note 44, *supra*), *Woodby* was not decided under the APA. Instead, it was decided under a statute that prescribed no standard of proof. Moreover, that case involved the "extreme deprivation" of deportation. In the present case, by contrast, the agency's standard of proof rests on the standard contained in the APA and no deprivation comparable to deportation is at issue.

[51] The Commission, like any other administrative agency, enjoys discretion in selecting a remedy that is appropriate to protect the public interest. When the agency adequately explains the reasons for the sanction that it selects, its decision will not be disturbed in the absence of a "patent abuse of discretion." *Moog Industries, Inc.* v. *FTC*, 355 U.S. 411, 414 (1958). Accord, *Butz* v. *Glover Livestock Commission Co.*, 411 U.S. 182, 185-187 (1973); *O'Leary* v. *SEC*, 424 F.2d 908, 911-912 (D.C. Cir. 1970); *Tager* v. *SEC*, 344 F.2d 5, 8-9 (2d

ingful review of the rationale for the severity of a sanction imposed by the Commission is assured by the requirement that the Commission "articulate carefully the grounds for its decision" (Pet. App. 27-28, 33-34).[52]

Cir. 1965); *Berko* v. *SEC*, 316 F.2d 137, 141-142 (2d Cir. 1963). This Court emphasized in *American Power & Light Co.* v. *SEC*, 329 U.S. 90, 113, 116, 118 (1946), that the choice of sanctions is uniquely a matter for agency determination. The Court stated that "where Congress has entrusted an administrative agency with the responsibility of selecting the means of achieving the statutory policy, 'the relation of remedy to policy is peculiarly a matter for administrative competence,'" and that a reviewing court would "imping[e] upon the Commission's rightful discretion were [it] to consider the various alternatives in the hope of finding one that [it] consider[s] more appropriate." *Id.* at 112, 118. In upholding an onerous order in that case, this Court did not suggest that a severe remedy requires extraordinary evidentiary standards.

[52] See generally *SEC* v. *Chenery Corp.*, 318 U.S. 80, 87, 94-95 (1943).

CONCLUSION

The judgment of the court of appeals should be affirmed.

Respectfully submitted.

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AUGUST 1980

APPENDIX

1. Sections 203(e) and (f) of the Investment Advisers Act of 1940, 15 U.S.C. 80b-3(e) and (f), provide:

> (e) The Commisison, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any investment adviser if it finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is in the public interest and that such investment advisers, or any person associated with such investment adviser, whether prior to or subsequent to becoming so associated—
>
> (1) has willfully made or caused to be made in any application for registration or report required to be filed with the Commission under this title, or in any proceeding before the Commission with respect to registration, any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein.
>
> (2) has been convicted within ten years preceding the filing of any application for registration or at any time thereafter of any felony or misdemeanor which the Commision finds—
>
> (A) involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense;
>
> (B) arises out of the conduct of the business of a broker, dealer, municipal securities dealer, investment adviser, bank, insurance company, or fiduciary;

(C) involves the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds or securities; or

(D) involves the violation of section 152, 1341, 1342, or 1343 or chapter 25 or 47 of title 18, United States Code.

(3) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, dealer, or municipal securities dealer, or as an affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security.

(4) has willfully violated any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, this title, or the rules or regulations under any such statutes or any rule of the Municipal Securities Rulemaking Board, or is unable to comply with any such provision.

(5) has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of any provision of the Securities Act of 1933, the Securities Exchange Act of 1934, the Investment Company Act of 1940, this title, the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board, or has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the pur-

poses of this paragraph (5) no person shall be deemed to have failed reasonably to supervise any person, if—

(A) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and

(B) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

(6) is subject to an order of the Commission entered pursuant to subsection (f) of this section barring or suspending the right of such person to be associated with an investment adviser which order is in effect with respect to such person.

(f) The Commission, by order, shall censure or place limitations on the activities of any person associated or seeking to become associated with an investment adviser, or suspend for a period not exceeding twelve months or bar any such person from being associated with an investment adviser, if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or bar is in the public interest and that such person has committed or omitted any act or omission enumerated in paragraph (1), (4), or (5) of subsection (e) of this section or has been convicted of any offense specified in paragraph (2) of said subsection (e) within ten years of the commencement of the proceedings under this subsection, or is enjoined from any action, conduct,

or practice specified in paragraph (3) of said subsection (e). It shall be unlawful for any person as to whom such an order suspending or barring him from being associated with an investment adviser is in effect willfully to become, or to be, associated with an investment adviser without the consent of the Commission, and it shall be unlawful for any investment adviser to permit such a person to become, or remain, a person associated with him without the consent of the Commission, if such investment adviser knew, or in the exercise of reasonable care, should have known, of such order.

2. Section 9(b) of the Investment Company Act of 1940, 15 U.S.C. 80a-9(b), provides:

> The Commission may, after notice and opportunity for hearing, by order prohibit, conditionally or unconditionally, either permanently or for such period of time as it in its discretion shall deem appropriate in the public interest, any person from serving or acting as an employee, officer, director, member of an advisory board, investment adviser or depositor of, or principal underwriter for, a registered investment company or affiliated person of such investment adviser, depositor, or principal underwriter, if such person—
>
> > (1) has willfully made or caused to be made in any registration statement, application or report filed with the Commission under this title any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such registration statement, application or report any material fact which was required to be stated therein; or
> >
> > (2) has willfully violated any provision of the Securities Act of 1933, or of the Securities Exchange Act of 1934, or of title II of this Act,

or of this title, or of any rule or regulation under any of such statutes; or

(3) has willfully aided, abetted, counseled, commanded, induced, or procured the violation by any other person of the Securities Act of 1933, or of the Securities Exchange Act of 1934, or of title II of this Act, or of this title, or of any rule or regulation under any of such statutes.

3. Sections 15(b)(4) and (6) of the Securities Exchange Act of 1934, 15 U.S.C. 78*o*(b)(4) and (6), provide:

(4) The Commission, by order, shall censure, place limitations on the activities, functions, or operations of, suspend for a period not exceeding twelve months, or revoke the registration of any broker or dealer if it finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or revocation is in the public interest and that such broker or dealer, whether prior or subsequent to becoming such, or any person associated with such broker or dealer, whether prior or subsequent to becoming so associated—

(A) has willfully made or caused to be made in any application for registration or report required to be filed with the Commission under this chapter, or in any proceeding before the Commission with respect to registration, any statement which was at the time and in the light of the circumstances under which it was made false or misleading with respect to any material fact, or has omitted to state in any such application or report any material fact which is required to be stated therein.

(B) has been convicted within ten years preceding the filing of any application for registra-

tion or at any time thereafter of any felony or misdemeanor which the Commission finds—

(i) involves the purchase or sale of any security, the taking of a false oath, the making of a false report, bribery, perjury, burglary, or conspiracy to commit any such offense;

(ii) arises out of the conduct of the business of a broker, dealer, municipal securities dealer, investment adviser, bank, insurance company, or fiduciary;

(iii) involves the larceny, theft, robbery, extortion, forgery, counterfeiting, fraudulent concealment, embezzlement, fraudulent conversion, or misappropriation of funds, or securities; or

(iv) involves the violation of section 152, 1341, 1342, or 1343 or chapter 25 or 47 of Title 18.

(C) is permanently or temporarily enjoined by order, judgment, or decree of any court of competent jurisdiction from acting as an investment adviser, underwriter, broker, dealer, or municipal securities dealer, or as an affiliated person or employee of any investment company, bank, or insurance company, or from engaging in or continuing any conduct or practice in connection with any such activity, or in connection with the purchase or sale of any security.

(D) has willfully violated any provision of the Securities Act of 1933, the Investment Advisers Act of 1940, the Investment Company Act of 1940, this chapter, the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board, or is unable to comply with any such provision.

(E) has willfully aided, abetted, counseled, commanded, induced, or procured the violation

by any other person of any provision of the Securities Act of 1933, the Investment Advisers Act of 1940, the Investment Company Act of 1940, this chapter, the rules or regulations under any of such statutes, or the rules of the Municipal Securities Rulemaking Board, or has failed reasonably to supervise, with a view to preventing violations of the provisions of such statutes, rules, and regulations, another person who commits such a violation, if such other person is subject to his supervision. For the purposes of this subparagraph (E) no person shall be deemed to have failed reasonably to supervise any other person, if—

(i) there have been established procedures, and a system for applying such procedures, which would reasonably be expected to prevent and detect, insofar as practicable, any such violation by such other person, and

(ii) such person has reasonably discharged the duties and obligations incumbent upon him by reason of such procedures and system without reasonable cause to believe that such procedures and system were not being complied with.

(F) is subject to an order of the Commission entered pursuant to paragraph (6) of this subsection (b) barring or suspending the right of such person to be associated with a broker or dealer.

* * * * *

(6) The Commission, by order, shall censure or place limitations on the activities or functions of any person associated, or seeking to become associated, with a broker or dealer, or suspend for a period not exceeding twelve months or bar any such

person from being associated with a broker or dealer, if the Commission finds, on the record after notice and opportunity for hearing, that such censure, placing of limitations, suspension, or bar is in the public interest and that such person has committed or omitted any act or omission enumerated in subparagraph (A), (D), or (E) of paragraph (4) of this subsection, has been convicted of any offense specified in subparagraph (B) of said paragraph (4) within ten years of the commencement of the proceedings under this paragraph, or is enjoined from any action, conduct, or practice specified in subparagraph (C) of said paragraph (4). It shall be unlawful for any person as to whom such an order suspending or barring him from being associated with a broker or dealer is in effect willfully to become, or to be, associated with a broker or dealer without the consent of the Commission, and it shall be unlawful for any broker or dealer to permit such a person to become, or remain, a person associated with him without the consent of the Commission, if such broker or dealer knew, or in the exercise of reasonable care should have known, of such order.

4. Section 7(c) of the Administrative Procedure Act, 5 U.S.C. 556(d), provides in pertinent part:

> Except as otherwise provided by statute, the proponent of a rule or order has the burden of proof. Any oral or documentary evidence may be received, but the agency as a matter of policy shall provide for the exclusion of irrelevant, immaterial, or unduly repetitious evidence. A sanction may not be imposed or rule or order issued except on consideration of the whole record or those parts thereof cited by a party and supported by and in accordance with the reliable, probative, and substantial evidence.* * *

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